

Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred as an incident of their sales of service. See 86 Ill. Adm. Code 140.101. (This is a GIL).

November 30, 1999

Dear Mr. Xxxxx:

This letter is in response to your letter dated August 3, 1999. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

We respectfully request a legal opinion regarding the application of Illinois sales and/or use tax to sale of payroll processing services, tax filing services and ancillary charges discussed below.

Facts

Our client (the 'Company') designs, sells, and supports small business accounting products, tax preparation and consumer finance desktop software products, financial supplies (such as computer checks, invoices and envelopes), and Internet-based products and services. In addition to these products, the Company has introduced an integrated online payroll processing and payroll tax filing service for small businesses. This online payroll service tracks the latest payroll tax regulations and automatically sends users the most up-to-date tax tables. The service assumes all responsibility and liability from the moment users approve and send their payroll information.

All processing of payroll information and the actual filing/transmittal of payroll tax information is conducted by a third party located outside of Illinois.

The payroll processing service calculates payroll earnings and deductions, prints payroll voucher checks, prepares federal 940, 941, and W-2 forms. Tax tables are available through paid subscription. Additionally, the Company provides an optional online direct deposit service. The online direct deposit service provides a client with the ability to set-up electronic employee paycheck deposits. Payroll information is entered and sent electronically to the service. The service deposits employees' checks for the client.

The online payroll tax filing service provides for the automatic payment and filing of federal and state taxes and the printing and mailing of W-2 forms. The Company takes responsibility for making a

client's tax payments and filings (upon approval), including payment of penalties. Additionally, the payroll tax service includes the tax table service as described above and toll free telephone support.

In addition to its standard fees for providing payroll processing and payroll tax filing services, customers may incur other additional fees for ancillary services or miscellaneous charges (i.e., account set-up fees, direct deposit fees, and late funding penalties).

Analysis/Conclusion

The Service Occupation Tax ('SOT') is imposed upon all persons engaged in the business of making sale of services on all tangible personal property transferred as an incident of a sale of service. Illinois Regulation §140.125 defines 'sale of services' as 'any transaction' except certain enumerated services. The SOT is based upon the 'selling price' of tangible personal property that is transferred as an incident of a sale of service. Chapter 35 of the Illinois compiled Statute §115/3-10 provides that the selling price of each item of tangible personal property transferred as an incident of a sale of service may be shown as a distinct and separate item on the serviceman's billing to the service customer. The company does not transfer personal property, other than original documents, to its clients in conjunction with the sale of services. The selling price of these documents is nominal and will be specifically stated on each billing. As such the amount of SOT owed will be nominal.

Please confirm that our conclusion is correct. If you have any questions or need any additional information, please call me at ####.

We are enclosing a copy of 86 Ill. Adm. Code 130.1995 concerning personalizing tangible personal property. Please note sellers of personalized items may be subject to Retailers' Occupation Tax liability if the items have intrinsic usefulness and thus have commercial value to persons other than the purchaser. Sellers of custom-printed items such as envelopes or letterheads that have no commercial value to persons other than the purchaser are subject to liability under the Service Occupation Tax Act. However, sales of envelopes and other tangible personal property not customized would be subject to Retailers' Occupation Tax liability and the seller would be required to register and collect Illinois tax.

The provision of payroll processing and tax filing services as described in your letter would be subject to liability under the Service Occupation Tax Act. Under the Service Occupation Tax Act, servicemen are taxed on tangible personal property transferred as an incident of their sales of service. Servicemen incur either Service Occupation Tax (SOT) liability or Use Tax liability in these transactions. The tax consequences depend upon the method used to calculate the liability. Servicemen may calculate their tax base in one of four ways: 1. separately stated selling price; 2. 50% of serviceman's entire bill; 3. SOT on

his cost price if he is a registered de minimis serviceman; or, 4. Use Tax on his cost price if he is an unregistered de minimis serviceman. Please see the enclosed copy of 86 Ill. Adm. Code 140.101, the Basis and Rate of the Service Occupation Tax.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations. Such servicemen collect a corresponding amount of Service Use Tax from their customers.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers.

We do not have sufficient information regarding your client to determine which of the methods would be appropriate for it to use. We hope the information we have provided is helpful.

The Department of Revenue maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

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If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Karl W. Betz
Associate Counsel

KWB:msk
Enc.